Daily Dose of Macro & Markets 29th July 2025: "Can Europe Continue to Outperform?"

The 'Daily Dose of Macro & Markets' is our new publication designed to speak to the key global macro debates that matter for markets (with 1 - 3 charts and two paragraphs). This product will be published every Tuesday, Wednesday, Thursday and Friday morning (early London time).

Europe or the US?

One of the key concerns of investors in recent months (and a key question in meetings) is whether Europe can further outperform the US. Year to date, that's been a clear theme (albeit less marked in recent months*).

In local currency terms, Europe (EuroSTOXX index) is up 12.6% (YTD), while the S&P500 is up only 8.6%. Converted into a common currency (e.g. USD), then the gap widens significantly (with EuroSTOXX +26.9% vs. SPX +8.6%). The marked weakness of the dollar (naturally) makes a significant difference (given the Euro is +12% versus the dollar in 2025).

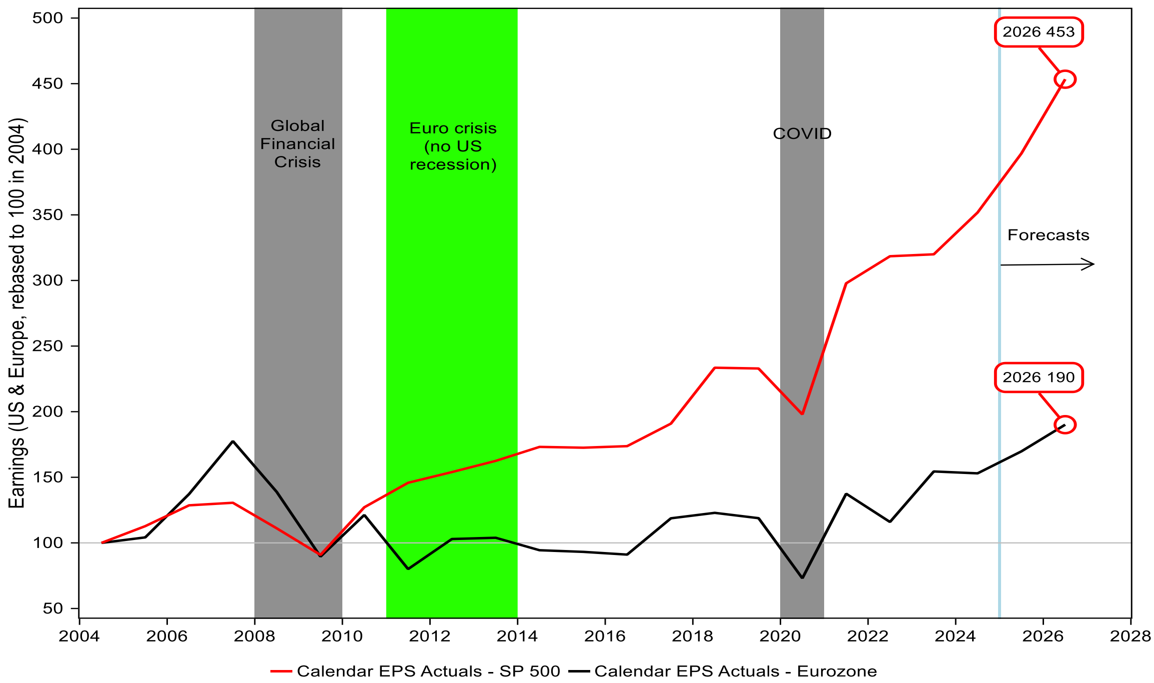
Looking forward, though, 3 key 'top level' factors will drive the relative performance: **i)** Any narrowing or widening of the **relative valuation** of the two markets (NB which is currently wide, with the S&P500, for example, trading on a forward PE ratio of 22.5x versus Europe on 14.7x forward ratio – see fig 2); **ii)** any change in the relative economic growth rates, and interest rate expectations of the two economies which, in turn, is likely to influence the **exchange rate** (as well as the earnings growth rate – see point iii); & **iii)** any shift in the **relative earnings growth** outlook. In other words, their relative stock market performance is dictated by the exchange rate, the earnings growth and the valuation which investors put on each market.

Over the past 15 years, since the GFC, it's easy to see why the US market has so markedly outperformed the European market. **Europe's cumulative stock market earnings growth** from 2004 through to 2022 **was 16%** (i.e. less than 1% per annum compounded). The **US's earnings growth** over that same time frame **was 218%** (that is from 100 to 318 on fig 1). That equates to 6.6% average, compound earnings growth per annum (including recessions and COVID). In that context, it's not surprising that the dollar was strong and that the US was the magnet for global capital (US exceptionalism etc).

The key question now, though, is how do the next few years look? Is Europe finally waking from its slumber? Are Trump's economic policies turning foreigners off from owning US assets (and therefore undermining the dollar)? Or has Europe's trade deal with the US (with 15% tariffs) done serious economic damage (and significantly impacted the outlook for European earnings growth)?

These are critical questions which we will be examining in more detail later this week in a Longview Letter. For now, though, we remain overweight European equities in our strategic asset allocation portfolio (with a particular focus on Spanish and Italian equity markets within the Eurozone).

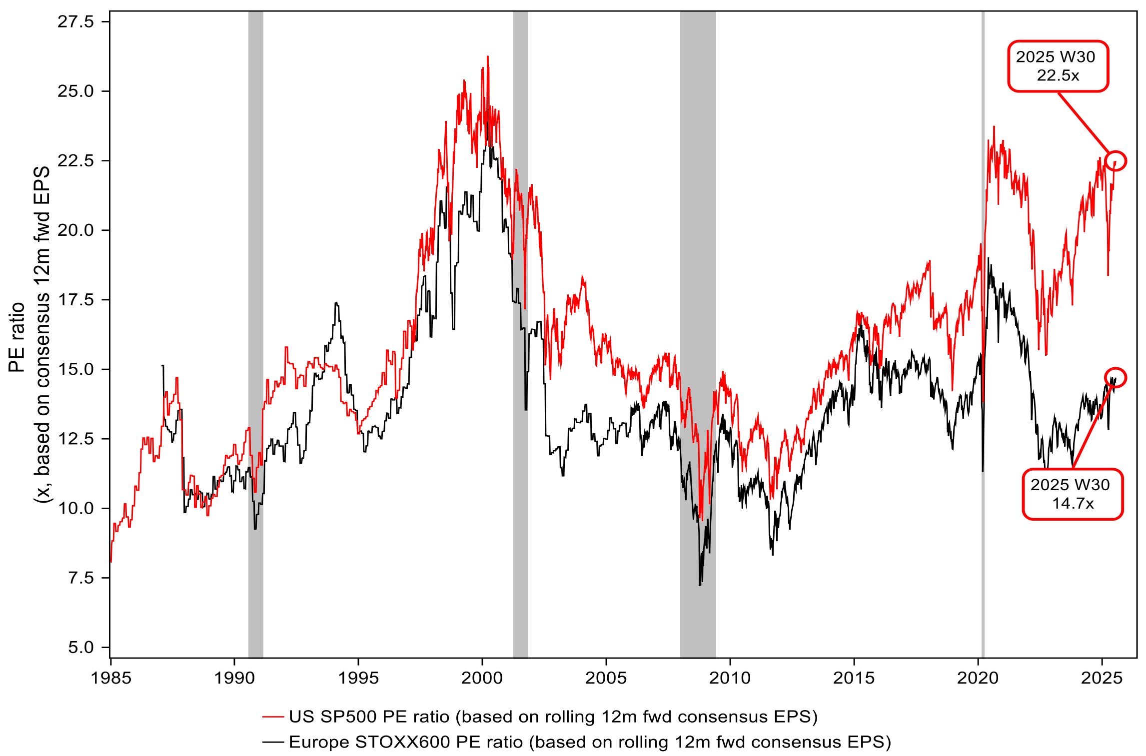
Fig 1: Eurozone vs. the US -> Stock market earnings (annual, actual and forecast, rebased to 100 in 2004)



Source: Longview Economics, Macrobond

*albeit since late April, the US & MAG7/tech sector has been outperforming and single stock leadership has narrowed.

Fig 2: US & European PE ratios (based on consensus rolling 12m fwd EPS)



Source: Longview Economics, Macrobond, FactSet